(5)

No. 86-1527

IN THE

SUPREME COURT OF THE UNITED STATES

McCLELLAN REALTY COMPANY, *et al.*,

Petitioners

v.

UNITED STATES OF AMERICA, *et al.*,

Respondents

RESPONSE BRIEF OF RESPONDENT JAMES J. HAGGERTY, ESQUIRE, TRUSTEE IN BANKRUPTCY FOR BLUE COAL CORPORATION AND GLEN NAN, INC.

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COUNTER STATEMENT OF THE FACTS

The District Court made four hundred and eighty one (481) specific findings of fact in the three (3) *Gleneagles* decisions.[1] This Counter Statement of the Facts represents the Trustee's best effort to summarize the facts relevant to the issues raised on appeal within the space limitation of this Brief.

Raymond Colliery is a Pennsylvania Corporation incorporated in 1962. In addition to owning surface lands and anthracite coal reserves located primarily in Lackawanna County, Pennsylvania Raymond Colliery also owned the stock of a number of subsidiary corporations including, *inter alia*, Blue Coal Corporation. Blue Coal Corporation also owned surface lands and anthracite coal reserves the bulk of which were located in Luzerne County, Pennsylvania (*Gleneagles I* at p. 563, finding nos. 1, 2 and 11). Between 1966 and November 26, 1973 Raymond Colliery and Blue Coal (hereinafter sometimes referred to collectively "the Raymond Group") engaged primarily in the business of Anthracite Coal production and the sale of their surplus surface lands (*Gleneagles I* at p. 563, finding no. 17). In all, the Raymond Group owned over thirty thousand (30,000) acres of land located in Luzerne and Lackawanna County in Pennsylvania (*Gleneagles I* at p. 564, finding no. 18). During this period of time the stock of the Raymond Group was owned or controlled by various members of the Gillen and Cleveland families (*Gleneagles* I at p. 563, finding no. 3).

Although between 1966 and 1973 Blue Coal was either the largest or one of the largest anthracite coal producers in the United States, it and other members of the Raymond Group faced a number of problems. In 1967 the Pennsylvania Department of Environmental Resources issued orders directing Blue Coal to reduce pollutants it was discharging into the public waterways. In order to comply with the DER directive, Blue Coal

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1. *United States v. Gleneagles Investment Co., Inc.*, 565 F. Supp. 556 (M.D. Pa. 1983); 571 F. Supp. 935 (M.D. Pa. 1983); and 584 F. Supp. 671 (M.D. Pa. 1984). The three decisions are hereinafter referred to as *Gleneagles* I, II and III.

began to phase out its deep mining operations and begin a conversion to "strip mining". This conversion to strip mining created substantial expenses in securing the different type of equipment needed in strip mining. These expenses depleted the cash reserves of the Raymond Group (*Gleneagles I* at p. 564, finding nos. 19 through 23).

During this period of time, which is just prior to the fraudulent conveyance which is the subject matter of this petition, the Raymond Group had a number of severe financial problems. Blue Coal was in default under a Loan Agreement the company had with Chemical Bank. The companies had serious and chronic cash flow problems and were forced to frequently discount their accounts receivable. The companies did not pay their local real estate taxes and these taxes were often not paid until the lands were listed for County tax sale. The Raymond Group was chronically delinquent in paying its trade payable. For the five (5) years prior to November 26, 1973 the coal production business of the Raymond Group operated at a loss and the company was supported financially largely by the sales of its surface lands (*Gleneagles I* at p. 564, finding nos. 28 through 37).

The unprofitability of the Raymond Group's coal production business led to disagreements among the Gillens and Clevelands as to the advisability of continuing to produce coal and, ultimately, led to their decision in 1972 to sell their Raymond Colliery stock (*Gleneagles I* at p. 565, finding nos. 41 and 42).

On February 2, 1972 the Gillens and Clevelands executed an option to sell the stock of Raymond Colliery to James J. Durkin, Sr. or his nominee for the sum of $8,500,000.00. This option was extended on a number of occasions due to Durkin's inability to obtain financing for the acquisition. A final option agreement was signed on August 3, 1973 between James Durkin, Sr. and the Gillens and Clevelands. His final option reduced the purchase price for the stock to $7,200,000.00. The reduction in the purchase price was the result of negotiations between the parties after the proposed purchasers learned that the Raymond Group had substantial liabilities to the Internal Revenue Service (*Gleneagles I* at p. 565, finding nos. 44 through 47). These delinquent tax liabilities related to taxes due the Internal Revenue

Service by the Raymond Group for each year since fiscal year ending June 30, 1966 (*Gleneagles I* at p. 572, finding no. 157).

The partner of James J. Durkin, Sr. in his plan to acquire the Raymond Group was James Riddle Hoffa, Sr., the former President of the Teamsters Union (*Gleneagles I* at p. 565, finding no. 48). Durkin's option to purchase the stock of Raymond Colliery was assigned by him to Great American Coal Company. Great American Coal Company was a holding company, the major asset of which was the option to purchase Raymond Colliery's stock. Originally, 50% of Great American stock was owned by Durkin and his wife, Anna Jean Durkin, and the remaining 50% was owned by Eugene Zafft, an attorney who held the stock as Jimmy Hoffa's nominee (*Gleneagles I* at p. 565, finding nos. 50 through 53).

Durkin and Hoffa sought financing during 1972 and 1973 from a series of lenders (*Gleneagles I* at p. 565, finding no. 54). All of Durkin and Hoffa's loan requests were predicated on using the assets of the Raymond Group as security for the loans requested. They also contemplated repaying the loans from the income and assets of the Raymond Group (*Gleneagles I* at p. 565, finding no. 56). One of the first lenders approached to finance the acquisition of the Raymond Group stock was the Teamsters Central State's Pension Fund in Chicago. The proposed financing with the Central State's Fund also involved Mellon Bank which was to issue a "bridge" loan until full funding from the Teamsters Central State's Pension Fund became available (*Gleneagles I* at p. 565, finding no. 57). During the negotiations over the Central State's Pension Fund financing, Rosenn, Jenkins & Greenwald, attorneys for Durkin, Chicago Title Insurance Company's Vice President and Associate General Counsel, Personnel at Mellon Bank, and the Central State's Pension Fund had extensive communications regarding the legality of pledging the Raymond Group's assets as security for a loan, the proceeds of which would be used to finance the purchase of Raymond Colliery's stock (*Gleneagles I* at p. 565, finding no. 58). Ultimately, the Central State's Pension Fund's commitment to finance the purchase of Raymond Colliery's stock was terminated in part because the proposed borrowers had failed to pay the required commitment

fee and in part because Mellon Bank determined that Blue Coal was financially weak (*Gleneagles I* at p. 565-566, finding no. 59).

Durkin and Hoffa then sought to finance the acquisition of the Raymond Group through Chemical Bank. Chemical refused to make the loan after officials of the Bank determined that the Raymond Group would not be able to repay the loan in a reasonable period of time (*Gleneagles I* at p. 566, finding no. 60).

In July of 1973 Durkin and Hoffa proposed to the Gillens and Clevelands that they provide "seller financing" in order to effect the sale of the Raymond Colliery stock. Durkin and Hoffa requested that the Gillens and Clevelands accept 4 million dollars in cash and a 4.5 million dollar secured Note in payment of the purchase price for their stock. The security for the Note was to be the assets of the Raymond Group. The Gillens and Clevelands rejected this proposal after their counsel advised them that any security interest granted by the Durkins pursuant to the proposed transaction would be susceptible to avoidance by creditors as a fraudulent conveyance (*Gleneagles I* at p. 566, finding nos. 61 through 63).

In view of the difficulties they were having in obtaining financing, James R. Hoffa sought the assistance of Hyman Green. In consideration of his assistance in obtaining financing, Hyman Green became a 10% stockholder in Great American Coal Company. Of the remaining 90% of the shares of Great American Coal Company 50% was held beneficially for James R. Hoffa and 40% was retained by Mr. & Mrs. Durkin (*Gleneagles I* at p. 566, finding nos. 65 and 66).

Through a loan broker contacted by Hyman Green, Hoffa, Durkin and Green were put in touch with Institutional Investors Trust, a real estate investment trust with headquarters in New York City (*Gleneagles I* at p. 566, finding nos. 67 and 68). In July of 1983 Institutional Investors Trust (hereinafter "IIT") issued its loan commitment to Great American Coal Company in the amount of $8,530,000.00. Out of the $8,530,000.00 IIT established an interest reserve of $1,530,000.00 (*Gleneagles I* at p. 566, finding nos. 72 and 75). The risk inherent in the proposed loan, which risk was foreseen by every other lender approached, is reflected in the aforesaid interest reserve and the high interest

rate charged by IIT: interest was to accrue at the rate of 5% above prime with a minimum interest charge of 12½% (*Gleneagles I* at p. 568, finding no. 105).

The primary attorney for IIT in this transaction was Walter M. Strine, Jr., of Morgan, Lewis & Bockius. IIT's attorneys structured the loan transaction (*Gleneagles I* at p. 574; *Gleneagles I* at p. 582). As structured, IIT was to make separate loans to Raymond Colliery, Blue Coal, Glen Nan and Olyphant in the aggregated amount of $8,530,000.00. These loans were to be secured by encumbrances on all of the assets of the companies (*Gleneagles I* at p. 566, finding no. 73). The borrowing companies as well as all other subsidiaries and affiliates within the Raymond Group were to each execute guarantee mortgages and security interests guaranteeing the full amount of the IIT loan. Each of the borrowing companies "immediately and as part of the overall transaction" lent to Great American virtually all of the IIT loan proceeds (*Gleneagles I* at p. 575). In return Great American Coal Company gave each of the borrowing companies its unsecured Promissory Note, which Notes were to be repaid on the same terms and conditions as the IIT loans (*Gleneagles I* at p. 570, finding no. 129).

Although IIT had issued its commitment, the proposed loan continued to trouble all concerned. James Hillary, IIT's chief in house counsel was concerned that the loan was structured in such a way that it might hinder the Raymond Group's present and future unsecured creditors (*Gleneagles I* at p. 566, finding no. 76). By letter of September 26, 1973 Walter M. Strine, Jr., advised Mr. Hillary that creditors might be able to challenge IIT's security interests since the bulk of the IIT loan proceeds was to be used to pay the Gillens and Clevelands for their stock. Strine also advised his client that the guarantee mortgages were also subject to challenge (*Gleneagles I* at p. 567, finding no. 78).

The IIT loan was originally set to close on October 31, 1973. Prior to that time extensive loan negotiations were being conducted by IIT, Great American and the Gillens and Clevelands (*Gleneagles I* at p. 567, finding no. 83). During these loan negotiation sessions representatives of IIT, Great American and the Gillens and Clevelands were all aware of the legal difficulties

inherent in encumbering corporate assets to finance the purchase of a corporation. The parties were particularily aware that such a transaction was subject to attack under the Bankruptcy Act and/or the Pennsylvania Uniform Fraudulent Conveyances Act (*Gleneagles I* at p. 567, finding no. 87). During these negotiations attorneys Walter M. Strine, Jr., Christian Day and Bernard Jacobs, all representing IIT, spent approximately 50 hours among themselves and the lawyers for the purchasers discussing the impact of the Uniform Fraudulent Conveyances Act on the loan transaction (*Gleneagles I* at p. 567, finding no. 88).

Ultimately, the October 31, 1973 closing was aborted by counsel for IIT. The closing was aborted primarily for two (2) reasons: (a) Walter Strine suspected that unidentified individuals were involved with Great American Coal (James R. Hoffa's involvement with Great American Coal was not disclosed to IIT but his involvement was suspected) and (b) the Gillens and Clevelands produced shortly before the closing financial statements for the fiscal year ending June 30, 1973 which revealed additional liabilities of the Raymond Group which had not previously been disclosed and which created considerable uncertainty regarding the Raymond Group's ability to meet its cash needs (*Gleneagles I* at pp. 567 and 568, finding nos. 89 and 93).

After the aborted closing further negotiations took place between IIT and the prospective borrowers (*Gleneagles I* at p. 568, finding no. 95). By that time IIT already had in its possession projections prepared by its loan administrator which showed that even using the most optimistic projections the Raymond Group would have substantial cash deficiencies upon the imposition of the IIT loan obligation (*Gleneagles I* at p. 567, finding no. 79). After the aborted closing and in order to induce IIT to reconsider the loan, Durkin's CPA and financial adviser, Charles Parente, prepared a "business plan" (*Gleneagles I* at p. 568, finding no. 96). When Mr. Parente's business plan is adjusted for mathematical errors and changes IIT subsequently made to the loan terms, it forecast substantial cash deficits after the IIT loan transaction (*Gleneagles I* at p. 568, finding no. 97). In fact, privately Mr. Parente, Rosenn, Jenkins & Greenwald, and Eugene Zafft warned James J. Durkin that he was taking a substantial risk in

purchasing the Raymond Group through the proposed method of financing (*Gleneagles I* at p. 581). Mr. Parente specifically warned that the Raymond Group had "not reflected sufficient profits and cash flow to cover debt equivalent to the purchase price of the stock over a reasonable period of time" (*Gleneagles I* at p. 581; Plaintiff's Exhibit 883).[2]

In these negotiations James Hillary, Vice President and General Counsel of IIT was still troubled by the structure of the loan and suggested that all actual and incipient creditors of the Raymond Group be notified of the proposed loan transaction and be asked to consent to the transaction. Mr. Hillary's suggestion was not followed (*Gleneagles I* at p. 568, finding nos. 98 and 99). Some of the loan provisions were renegotiated and a loan closing was rescheduled for November 26, 1973. Between the aborted closing and November 26, 1973 no significant changes were made to the structure of the loan (*Gleneagles I* at p. 568, finding nos. 100 through 103). The loan was closed on November 26, 1973. The rights between the parties were defined largely by the Note Purchase and Loan Agreement. The companies' consolidated financial statement for the six (6) months ending December 31, 1973 indicates that the company had current assets of $3,189,096.21 and current liabilities of $4,739,612.22 (*Gleneagles I* at p. 569, finding no. 112). Based upon this statement the Raymond Group was in default of the loan agreement from its inception (*Gleneagles I* at p. 569, finding no. 113). Individual members of the Raymond Group were also in default under the working capital and debt to equity ratio covenants of the Note Purchase and Loan Agreement (*Gleneagles I* at p. 569, finding no. 114).

One of the provisions renegotiated between the aborted closing and the closing of November 26, 1973 was the land release provision of the Note Purchase and Loan Agreement (*Gleneagles I* at p. 568, finding no. 100). As previously noted, the

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2. Plaintiff's Exhibit 883 is a letter to Durkin from Parente which Parente insisted Durkin countersign thereby acknowledging receipt of and an understanding of the letter.

Raymond Group's coal operations consistently produced losses. The cash flow of the companies was almost completely dependent on revenues it obtained from the sale of its surplus lands. Under the terms of the Chemical Bank mortgage, the Raymond Group paid interest at the rate of 2 points above Chemical's prime rate. Additionally, Chemical Bank was obligated to release a parcel of surface land from the lien of its mortgage upon receipt of one-third of the net proceeds of a sale (*Gleneagles I* at p. 564, finding no. 25). The IIT release provisions were much stricter. Under the IIT agreement for the years 1974 and 1975 out of $2,500,000.00 in land sales the company would only have $667,500.00 available for use by the Raymond Group (*Gleneagles I* at p. 569, finding no. 116 and 117).

The Note Purchase and Loan Agreement also required that Morgan, Lewis & Bockius issue an opinion letter to its client, IIT. Despite receiving one (1) oral request and six (6) written requests from IIT for the opinion letter, Walter M. Strine, Jr., Esquire, of Morgan, Lewis & Bockius refused to issue an opinion letter. Strine did not issue an opinion letter because of his concern as to the validity of the mortgage (*Gleneagles I* at p. 570, finding nos. 123 through 126).

The closing of November 26, 1973 was identical to the aborted closing inasmuch as immediately upon receipt of the IIT loan proceeds, the borrowing companies made loans to Great American in return for Great American's unsecured Promissory Note. The loans to Great American were then applied toward the purchase price of the Raymond Colliery stock (*Gleneagles I* at p. 570, finding nos. 128 through 130).

All parties knew that Great American did not have the ability to repay the notes nor could it legally do so under the terms of IIT's Note Purchase and Loan Agreement (*Gleneagles I* at p. 571, finding nos. 147 and 148). Great American convenanted under the loan agreement with IIT to remain a holding company until IIT's loan was repaid. Great American's sole source of income after November 26, 1973 were dividends which might be declared by Raymond Colliery. However, the Note Purchase and Loan Agreement further provided that until IIT was paid, the borrowing companies were prohibited from paying dividends or making any other distribution in cash or securities on

any shares of its capital stock (*Gleneagles I* at p. 571, finding nos. 143 through 145). In fact, Great American never did make any payments on the Notes given to the borrowing companies and Great American used the Raymond Group's assets to repay loans it secured from other lenders (*Gleneagles I* at p. 571, finding no. 149). IIT's own attorneys structured the entire November 26, 1973 transaction (*Gleneagles I* at p. 582).

Chicago Title Insurance Co. issued title insurance covering IIT's mortgage. The original write up of the policy had an exclusion clause which would have given Chicago Title Insurance Co. a defense should creditors seek to have the IIT mortgages set aside as fraudulent conveyance (*Gleneagles I* at p. 571, finding no. 150). The exclusion clause was removed by Chicago Title in exchange for Durkins' agreement to indemnify Chicago Title if the mortgages were set aside as fraudulent conveyances (*Gleneagles I* at p. 571, finding no. 151). Attorney Bernard Jacobs, another of IIT's legal counsel, would have advised IIT not to make these loans if Chicago Title had not removed its exception as to creditors' rights (*Gleneagles I* at p. 571, finding no. 152). In order to insure that Chicago Title could not assert an exception in the title insurance report for defects known to the owner but not disclosed to Chicago Title, Attorney Jacobs had James Durkin advise Chicago Title in writing that some of the loan proceeds were to be used to pay the selling stockholders for their stock thus subjecting Chicago Title Insurance Co. to liability if the loans were set aside as fraudulent conveyances (*Gleneagles I* at p. 571-572, finding no. 153).

As virtually everyone predicted, the financial condition of the Raymond Group worsened after the November 26, 1973 closing (*Gleneagles III* at p. 675, finding no. 416). Following the closing the Raymond Group lacked the funds to pay its day-to-day routine expenses including those for materials, supplies, telephone and other utilities (*Gleneagles I* at p. 572, finding no. 161). The Raymond Group was also unable to pay its delinquent or its current real estate taxes following the closing (*Gleneagles II* at p. 942, finding no. 75). Within two (2) months of the closing, the deep mining operations of Blue Coal were shut down and within six (6) months of the closing, the Raymond Group ceased

all of its strip mining operations (*Gleneagles I* at p. 572, finding nos. 162 and 164). After terminating its coal mining activities the companies could not fulfill their existing coal contracts and became liable for damages for breach of contract (*Gleneagles I* at p. 572, finding no. 165). The Plaintiffs in the breach of contract actions also exercised their right of set off against accounts they owed the Raymond Group (*Gleneagles I* at p. 572, finding no. 166).

Within seven (7) months of the closing, the Raymond Group became involved in litigation commenced by the Commonwealth of Pennsylvania and the Anthracite Health & Welfare Fund regarding the company's failure to fulfill its backfilling requirements and its failure to pay its contribution to the Health & Welfare Fund. This litigation resulted in injunctions against the companies which prevented them from moving or selling their equipment until their obligations were satisfied (*Gleneagles I* at p. 572, finding no. 167). Despite its extreme financial condition between November 26, 1973 and April, 1976 the Raymond Group did pay to IIT a total of $4,589,640.00 on account of the IIT mortgages (*Gleneagles III* at p. 675, finding no. 417).

James Tedesco is a principal of Pagnotti Enterprises and virtually all of the petitioners, including McClellan Realty, in this action. Prior to 1972 Tedesco had numerous contacts with the Raymond Group (*Gleneagles II* at p. 938, finding no. 1). In fact, in 1965 James Tedesco made an unsuccessful attempt to purchase the coal reserves of Blue Coal (*Gleneagles II* at p. 938, finding no. 2). Prior to the 1973 loan transaction representatives of Pagnotti Enterprises and representatives of the Raymond Group entered into conspiracies to fix the price and control production of anthracite coal (*Gleneagles II* at p. 939, finding no. 27).

James Tedesco has known James Durkin for more than forty (40) years (*Gleneagles II* at p. 938, finding no. 7). Tedesco assisted Durkin in the purchase of the Raymond Group by providing an appraisal of a certain Dragline and by making certain loans to Durkin through companies Tedesco controlled, Old Forge Bank and No. 1 Contracting Co. (*Gleneagles II* at p. 939, finding no. 29; *Gleneagles II* at p. 938, finding no. 10). At the

time Durkin secured the option to purchase the stock of Raymond Colliery in 1972, Pagnotti Enterprises and the Raymond Group were the two (2) top producers of anthracite coal in the United States (*Gleneagles II* at p. 938, finding no. 4).

When James Durkin sought financing from the Old Forge Bank and No. 1 Contracting he told James Tedesco that he had reached an agreement for the acquisition of the Raymond Group (*Gleneagles II* at p. 938, finding no. 15). The loans Durkin sought from the Tedesco companies were informally granted inasmuch as no loan applications or financial statements were requested or reviewed (*Gleneagles II* at p. 939, finding no. 23).

The loan from No. 1 Contracting Co. was secured in an extremely curious way. No. 1 Contracting lent James and Anna Jean Durkin the sum of $200,000.00 toward the purchase of the Raymond Colliery stock and received collateral in the form of $300,000.00 in cash (i.e. "greenbacks") (*Gleneagles II* at p. 939, finding no. 17). This $300,000.00 cash collateral for the $200,000.00 loan was not invested or placed on deposit but was kept in a safe deposit box at the Old Forge Bank until the loan was repaid (*Gleneagles II* at p. 939, finding no. 20). Although the District Court directly requested Tedesco to make full disclosure regarding all of the facts and circumstances of this loan he refused to do so (*Gleneagles II* at p. 956). This and other factors led the District Court to find that "an unusually close relationship" existed between the Durkins and James Tedesco (*Gleneagles II* at p. 955).

The Raymond Group's difficulties with creditors following the closing were well publicized in the Wilkes-Barre and Scranton areas (*Gleneagles II* at p. 945, finding no. 124). In addition, James Tedesco was personally aware of the difficulties the Raymond Group was having with the creditors. In January of 1974 James Durkin advised James Tedesco that the Raymond Group was losing money on its coal production business and intended to cease coal mining (*Gleneagles II* at p. 940, finding no. 35). In fact, James Tedesco attempted to negotiate with Durkin and Hyman Green a "lease to exhaustion" of all of the coal reserves of the Raymond Group (*Gleneagles II* at p. 940, finding no. 32). Additionally, James Tedesco knew in 1974 of Durkin's

efforts to liquidate various assets of the Raymond Group (*Gleneagles II* at p. 939, finding no. 31). Tedesco was also aware that Durkin became seriously delinquent in the loans he obtained from Old Forge Bank and No. 1 Contracting (*Gleneagles II* at p. 940, finding no. 43). Although the loan was delinquent, No. 1 Contracting never sought recourse against the $300,000.00 in cash collateral (*Gleneagles II* at p. 940, finding no. 52).

On September 15, 1986 IIT sent a formal Notice of Default to the Raymond Group. At the same time IIT accelerated the balance due on its loans (*Gleneagles II* at p. 941, finding no. 61). On September 29, 1976 IIT confessed judgment against the borrowers on their notes (*Gleneagles II* at p. 941, finding no. 63).

At about that time Lawrence Sullivan of IIT asked James Tedesco whether Pagnotti Enterprises would be interested in purchasing the IIT mortgages. Tedesco indicated that his company might be willing to entertain such a purchase and requested documentation and data on the mortgages (*Gleneagles II* at p. 941, finding nos. 64 and 65).

Sullivan sent to James Tedesco copies of the four (4) mortgages and an index of items contained in the twelve (12) closing binders for the November 26, 1973 loan (*Gleneagles II* at p. 941, finding no. 66). The index to the closing binders reveals on its face that the proceeds of the IIT loan had financed the 1973 purchase by Great American of Raymond Colliery's stock (*Gleneagles II* at p. 944, finding no. 118).

In October, 1976 James Tedesco was also approached by Hyman Green, the then sole shareholder of the Raymond Group save for any equitable interest the estate of James Hoffa would have had in the companies. (Hoffa disappeared in July, 1975). Green advised Tedesco that he believed that the IIT mortgages could be purchased at a deep discount (*Gleneagles II* at p. 941, finding no. 68). Green and Tedesco also discussed the possibility of Pagnotti Enterprises purchasing the stock of the Raymond Group but James Tedesco lost interest in such a purchase once he reviewed financial information on the Raymond Group (*Gleneagles II* at p. 942, finding no. 74).

The companies failed to pay county real estate taxes and in the fall of 1976 Luzerne and Lackawanna County scheduled all of the Raymond Group's real estate and coal holdings for county tax sale (*Gleneagles II* at p. 942, finding no. 76). Some of the delinquent real estate taxes owed by Raymond Colliery and Blue Coal predated the IIT mortgages and IIT believed that under Pennsylvania Law a tax sale based upon taxes with the priority higher than its mortgage would serve to discharge IIT's mortgage lien (*Gleneagles II* at p. 942, finding no. 81).

Tedesco continued to negotiate with IIT on the purchase of the mortgages. At about the same time Tedesco and Hyman Green entered into an Agreement, the exact terms of which were not known nor revealed to the District Court regarding Tedesco's acquisition of the lands of Blue Coal and Raymond Colliery at the 1976 tax sales. As a result of the Agreement, Hyman Green did not take any action to protect the Raymond Group or its assets. Hyman Green did not even attend the Luzerne and Lackawanna County tax sales. L. Robert Lieb, counsel for IIT avoided any discussions with James Tedesco regarding whether or not an agreement had been made with Hyman Green because Mr. Lieb did not want to be charged with this knowledge (*Gleneagles II* at p. 949, finding nos. 196 through 199).

In their negotiations on the purchase of the mortgages, IIT emphasized to Mr. Tedesco that the mortgages were being sold "as is" with no warranties or representations (*Gleneagles II* at p. 944, finding no. 109).

On December 15, 1976 IIT and Pagnotti Enterprises executed a contract for the sale of the IIT loans, mortgages, and security interests (*Gleneagles II* at p. 945, finding no. 135). The sale of the mortgages were understood by both IIT and James Tedesco to be a means of effecting a bargain purchase of the coal, surface lands, and other assets of the Raymond Group. To deal with the upcoming county tax sales an escrow account was open and a bidding strategy arrived at to pay the taxes on the lands with a priority higher than the IIT mortgages (*Gleneagles II* at p. 945, finding no. 140). Luzerne and Lackawanna Counties continued their preparation for the County Tax Sales which were

scheduled December 17, 1976. On December 17 1976, John H. Doran, Esquire, representing independent creditors of Blue Coal Corporation, appeared at the Luzerne County Tax Sale and announced that an Involuntary Petition in Bankruptcy had been filed against Blue Coal Corporation and, therefore, by force of the Automatic Stay of the Bankruptcy Act, the County tax sale was stayed (*Gleneagles II* at p. 947, finding no. 177). A similar Petition in Bankruptcy was not filed with regard to Raymond Colliery, and the Lackawanna County tax sale went forward on December 17, 1976 (*Gleneagles II* at p. 948, finding no. 181). Tabor Court Realty, a corporation established by Tedesco and Lieb for the purpose of bidding in the Lackawanna County tax titles of the Raymond Group, submitted the only bid at the County tax sale which bid was in the amount of the upset price (*Gleneagles II* at p. 948, finding no. 188).

The District Court found that Pagnotti Enterprises either knew or should have known that the IIT mortgages were not supported by fair consideration and rendered the Raymond Group insolvent (*Gleneagles II* at p. 592). The Court further found that Pagnotti Enterprises knew that a portion of the IIT loan proceeds were used to pay the prior shareholders of Raymond Colliery for their stock (*Gleneagles II* at p. 953).

Following the closing on the IIT mortgages Joseph R. Solfanelli, counsel to McClellen, hand-delivered to Hyman Green a Notice that McClellan Realty intended to foreclose its security interest in certain machinery, equipment, culm, other personal property and the capital stock of Raymond Colliery and Great American Coal at one or more private sales to be conducted after February 12, 1978. McClellan Realty did foreclose on its security interest in equipment, culm, silt and other personality at a private sale conducted on February 28, 1978. McClellan bought in that collateral at that time. McClellan then signed an Agreement purporting to sell all of those assets to Loree Associates for the sum of $50,000.00. Loree Associates is a partnership consisting of members of the Pagnotti, Tedesco and Ventre families, the same families that control Pagnotti Enterprises. No schedule of the specific assets purportedly sold to Loree was ever prepared. The assets were not advertised for

sale. The assets were not offered for sale to any person or entity not affiliated with Pagnotti Enterprises (*Gleneagles III* at pp. 675-676, finding nos. 422 through 429). Thereafter the capital stock of Raymond Colliery was also foreclosed upon at private sale with Joseph Solfanelli bidding in the same for $1.00 as Trustee for the Pagnotti Group (*Gleneagles III* at p. 676, finding no. 430).

McClellan Realty did not give any notice of the aforesaid foreclosure sales under the Uniform Commercial Code to the Trustee in Bankrputcy for Blue Coal Corporation. McClellan did not secure appraisals on any of the collateral it foreclosed upon at private sale (*Gleneagles III* at p. 676, finding no. 432).

REASONS FOR DENYING THE WRIT

The trial of this matter in the district court exceeded one hundred and twenty (120) trial days and resulted in three (3) district court opinions. Thereafter the petitioners appealed to the United States Court of Appeals for the Third Circuit which sustained the Judgment of the District Court except in one very important respect. All of the important issues in the litigation involved the application of Pennsylvania state law. Assuming, for the moment, that the petitioners are correct and that there is a conflict between the Third Circuit's application of Pennsylvania law and the Eleventh Circuit's interpertation of a similar provision under the Bankruptcy Code, this would not form a basis for this court to grant petitioners' prayer for a Writ of Certiorari. *Ruhlin v. New York L. Ins. Co.*, 304 U.S. 202, 206 (1938). ("As to questions controlled by state law, however, conflict among circuits is not of itself a reason for granting a writ of certiorari. The conflict may be merely corollary to a permissible difference of opinion in the state courts").

The only reason cited by petitioners for the granting of certiorari is a alleged conflict between the Third Circuit and the Court of Appeals for the Eleventh Circuit in the interpretation of "fair equivalence" under the Pennsylvania Fraudulent Conveyance Act and the Federal Bankruptcy Code. The conflict allegedly exists between the Third Circuit's decision in this case

and a short *per curiam* decision from the Eleventh Circuit's non-argument calendar in the case of *In Re: Greenbrook Carpet Co., Inc.*, 722 F.2d 659 (11th Cir. 1984). In fact, there is no conflict.

First of all, unlike this case *Greenbrook* is not a leveraged buy-out case. As noted by the Cicuit Court a "leveraged buy-out" is a shorthand expression which describes a corporate acquisition method in which investors acquire a corporation using very little equity and very large debt. The crucial aspect of such a transaction as far as the target company's other creditors are concerned is that the leveraged buy-out typically envisions granting a lender a security interest in all of the target company's assets. The loan proceeds are then paid, directly or by subterfuge, to the old equity holders. *United States v. Tabor Court Realty Corp.*, 803 F.2d 1288, 1293 (3d Cir. 1986).

Greenbrook Carpet does not share the typical characteristics of a leveraged buy-out. The first question to be asked in any fraudulent conveyance analysis of any corporate transaction is: were the corporation's general unsecured creditors in a more advantageous position before or after the transaction? In *Greenbrook Carpet* the unsecured creditors of Greenbrook were in virtually the same position before and after the transaction. Before the transaction, Greenbrook Carpet had Three Hundred and Fifty Thousand ($350,000.00) Dollars less in debt. After the transaction while Greenbrook had an additional Three Hundred and Fifty Thousand ($350,000.00) Dollars in debt, it also had a note from the Greens in a like amount and, more importantly, a security interest in the stock of Lewis Carpet Mills, Inc. which, presumably, had a fair value of Three Hundred and Fifty Thousand ($350,000.00) Dollars.

The before and after picture with regard to the acquistion of the Raymond Group is in stark contrast to the Greenbrook transaction. After the Raymond Group acquistion the companies had new debt to IIT in the amount of $8.5 Million Dollars. The only thing the companies received in return were the unsecured promissory notes of Great American Coal Company which Great American could not practically or legally pay. The detriment to the companies' unsecured creditors is obvious.

The petitioners also rely upon *Greenbrook Carpet* for the proposition that the Third Circuit and the District Court should not have collapsed what it alleges to be two distinct transactions. Initially, it should be observed that the analysis in *Greenbrook Carpet* would not have been different if the Eleventh Circut did collapse the multiple transactions. In the end, Greenbrook Carpet, directly or indirectly, parted with Three Hundred and Fifty Thousand ($350,000.00) Dollars and received a security interest in stock of an identical value. Furthermore, the courts below were sitting as courts of equity and had the power and duty to assure that substance not give way to form. They were obligated to "sift the circumstances" surrounding the loan transaction. *Pepper v. Litton*, 308 U.S. 295, 305 and 308 (1939). No matter how technically legal each step of the transaction may have been, once it's fraudulent scheme became apparent the court was bound to undo it. *I.d.* at 312; *See also, Shapiro v. Wilgus*, 287 U.S. 348 (1932); *Iscovitz v. Filderman*, 334 Pa. 585 (1939). By the petitioners' own admission, the only way the transaction can survive fraudulent conveyance analysis is for the court to close its eyes and exalt form over substance. The District Court and the Circuit Court rightly refused to do so, holding that the District Court's factual findings supported its holding that the two exchanges were part of one integrated transaction. *United States v. Tabor Court, supra*, at 1302. The court's approach is further bolstered once it is remembered that the lender's attorney was aware of the fraudulent conveyance difficulties in the transaction and was the one who structured the loan transaction in an attempt to minimize the lender's exposure. *Gleneagles I*, at p. 574 and 582.

Another very significant reason exists to deny certiorari in this case. This court's rules provide that "Only the questions set forth in the petition or fairly included therein will be considered by the court". *United States Supreme Court Rules* 21.1 (a). Although there are admittedly exceptions to this rule in extraordinary circumstances, the rule has been and should be enforced. *Irvine v. California*, 347 U.S. 128, 129 (1954); *Lawn v. United States*, 355 U.S. 339, 362 n. (1958).

The petitioners request for Certiorari is based upon its allegation that the court misinterpreted the application of "fair consideration" or "reasonably equivalent value" under *39 Pa. Stat. Sections 354, 355 and 356*. The petitioners do not urge either in their question presented or in their petition that the Circuit Court opinion be disturbed in any other respect. It is respectfully submitted that this is a fatal flaw in this petition.

In addition to holding that Sections 354, 355 and 356 of the Pennsylvania Fraudulent Conveyance Act had been violated, the Circuit Court had two other additional holdings adversed to the petitioners both of which are case dispositive. First of all, the Circuit Court sustained the District Court's finding that the mortgage liens were void under Section 357 of the Fraudulent Conveyance Act as intentional frauds. Neither "fair consideration" nor "reasonably equivalent value" play any part in the analysis of a transaction under Section 357. Accordingly, they cannot, by any stretch of the imagination, be considered to be "fairly included" in the question presented. Furthermore, the Circuit Court reversed the District Court on one issue. The effect of this reversal was to extinguish the mortgage liens in question due to McClellan Realty's commercially unreasonable foreclosure against other collateral. *United States v. Tabor Court Realty Corp.*, supra., at 1307.

McClellan has not sought the review of this Court on either of these issues. Accordingly, even if this Court were inclined to favor any of McClellan's arguments it could not grant the petitioner any effective relief. This Court is constitutionally prohibited from exercising its judicial power in the absence of a live case or controversy. *DeFunis v. Odegaard*, 416 U.S. 312, 315 (1974). This case is moot. *Tiverton Bd. of License Comm'rs. v. Pastore*, 469 U.S. 238 (1985); *United States v. Alaska S.S. Co.*, 253 U.S. 113 (1920).

The petitioners have made several other arguments in its petition which deserve only the briefest comment. The petitioner has argued that the decision in this case will somehow deter lenders from making loans to financial ailing companies. This is a red herring. Legitimate lenders to ailing or healthy companies have nothing to fear from this decision. There would have

been no basis for attacking the I.I.T. security if, in fact, the loan proceeds stayed in the companies and helped their chronically bad cash flow or helped it to obtain more efficient equipment or were used for any other legitimate business purpose.

Next, petitioners argue that the Court's decision somehow gives the creditors of the Raymond Group a windfall "double recovery" in view of a settlement the creditors obtained from the old shareholders of the company. Both the District Court and the Circuit Court fairly considered this argument and found that it was not factually supported. *United States v. Tabor Court Realty Corp., supra.*, at 1300.

Finally, petitioner's argue once again that some "good" part of it's mortgage exists which deserves some protection. Once again, both the District Court and the Circuit Court fairly considered this argument and declined to agree with the petitioners. *United States v. Tabor Court Realty Corp., supra.*, at 1300 and 1301 n.7.

CONCLUSION

For the foregoing reasons the petition for Writ of Certiorari should be denied.

Respectfully submitted,

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CERTIFICATION OF SERVICE

The undersigned ROBERT C. NOWALIS, ESQUIRE, hereby certifies that he is a member of the Bar of the Supreme Court of the United States and that a true and correct copy of the foregoing Response Brief of respondent James J. Haggerty, Esquire, Trustee in Bankruptcy for Blue Coal Corporation and Glen Nan, Inc. was served upon the following counsel by placing a copy of the same in the First Class U.S. Mail postage prepaid, on the 5th day of June, 1987 addressed as follows:

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